Franchise Tax Board

ANALYSIS OF ORIGINAL BILL

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Related Bills: | Telephone: 845-6979 | Introduced Date: 02/24/1999

Attorney: Doug Bramhall | Sponsor:

SUBJECT: Manufacturers' Investment Credit/Extend to Mineral Extraction Activities

SUMMARY

Under the Bank and Corporation Tax Law (B&CTL), this bill would expand the Manufacturers' Investment Credit (MIC) to include specified activities related to extracting nonmetallic minerals described in Standard Industrial Classification (SIC) Codes 1411 to 1499.

EFFECTIVE DATE

As a tax levy, this bill would become effective immediately and would apply to income years beginning on or after January 1, 1999.

LEGISLATIVE HISTORY

SB 671 (Stats. 1993, Ch. 881); SB 676 (Stats. 1994, Ch. 748); SB 38 (Stats. 1996, Ch 954.); SB 1106 (Stats. 1997, Ch. 604); AB 2798 (Stats. 1998, Ch. 323); AB 473 (1999/2000).

SPECIFIC FINDINGS

Existing state and federal laws generally allow a depreciation deduction for the obsolescence or wear and tear of property used in a business or investment property. The property must have a limited, useful life of more than one year and includes equipment, machinery, vehicles and buildings, but excludes land. Property is assigned to specific classifications related to the number of years of its useful life. The property then may be depreciated over the number of years of its useful life (recovery period).

Existing state and federal laws allow a taxpayer to deduct expenses paid or incurred in the ordinary course of a taxpayer's business.

Existing state law allows taxpayers to use various credits against tax such as the MIC. The MIC allows qualified taxpayers a credit equal to 6% of the amount paid or incurred after January 1, 1994, for qualified property that is placed in service in California.

For purposes of the MIC, a qualified taxpayer is any taxpayer engaged in manufacturing activities described in specified codes in the SIC Manual. Qualified property is any of the following:

Board Position:

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Department Director | Date

Gerald Goldberg | **3/23/1999**

1) Tangible personal property that is defined in Section 1245(a) of the Internal Revenue Code (IRC) and used primarily:

- for manufacturing, processing, refining, fabricating or recycling of property;
- for research and development;
- for the maintenance, repair, measurement, or testing of otherwise qualified property; or
- for pollution control which meets or exceeds state or local standards.

2) The value of any capitalized labor costs directly allocable to the construction or modification of the property listed in #1 above or for special purpose buildings and foundations listed in #3 below.

3) Special purpose buildings and foundations that are an integral part of manufacturing, refining, processing or fabricating, or research and storage facilities that are part of the process, which are used by qualified persons performing manufacturing activities described in specific codes relating to computer, accounting, and office machines, electronic equipment and accessories, biotech or biopharmaceutical activities, semiconductor equipment manufacturing activities and certain aerospace manufacturing activities.

For taxpayers engaged in computer programming and computer software related activities, qualified property includes (1) computers and computer peripheral equipment used in those businesses primarily for the development and manufacture of prepackaged software or custom software prepared to the special order of the purchaser who uses the program to produce and sell or license copies of the program as prepackaged software, and (2) the value of any capitalized labor costs directly allocable to the construction or modification of such property.

The MIC explicitly excludes certain types of property from the definition of qualified property, including equipment used in the extraction process.

The MIC provides a variety of special rules for costs paid pursuant to a binding contract and leased property. The credit may be carried over until exhausted, for a maximum of eight years. For small businesses, this carryover period is extended to ten years. The taxpayer must recapture any credit previously allowed if the property is removed from California, disposed of to an unrelated party or converted to an unauthorized use within one year from the date the property is first placed in service in California.

The MIC will become inoperative on January 1, 2001, or on the January 1 of the earliest year after 2001 if the total employment in manufacturing in this state does not exceed by 100,000 jobs the total employment in manufacturing in this state on January 1, 1994. The Employment Development Department (EDD) is required to report to the Legislature annually on this determination.

Certain “new businesses” (as defined) may claim an exemption from sales and use tax instead of this tax credit. The existing sales and use tax law also allows a taxpayer to claim a refund for the sales or use tax that was paid on the purchase of qualified property rather than claiming the MIC.

Under the B&CTL, this bill would include specified lines of business relating to extracting nonmetallic minerals in the definition of "qualified taxpayer" for the MIC. These activities are described in SIC Codes 1411 to 1499, inclusive, as follows:

141 DIMENSION STONE
- 1411 Dimension Stone

142 CRUSHED AND BROKEN STONE, INCLUDING RIPRAP
- 1422 Crushed and Broken Limestone
- 1423 Crushed and Broken Granite
- 1429 Crushed and Broken Stone, Not Elsewhere Classified

144 SAND AND GRAVEL
- 1442 Construction Sand and Gravel
- 1446 Industrial Sand

145 CLAY, CERAMIC AND REFRACTORY MINERALS
- 1455 Kaolin and Ball Clay
- 1459 Clay, Ceramic and Refractory Minerals, Not Elsewhere Classified

147 CHEMICAL AND FERTILIZER MINERAL MINING
- 1474 Potash, Soda, and Borate Minerals
- 1475 Phosphate Rock
- 1479 Chemical and Fertilizer Mineral Mining, Not Elsewhere Classified

148 NONMETALLIC MINERALS SERVICES, EXCEPT FUELS
- 1481 Nonmetallic Minerals, Except Fuels

149 MISCELLANEOU NONMETALLIC MINERALS, EXCEPT FUELS
- 1499 Miscellaneous Nonmetallic Minerals, Except Fuels

This bill would add SIC Codes 1411 to 1499, inclusive, to the definition of "qualified property" for the MIC. In addition, the activity test for qualified property would be modified to include extracting of property, beginning at the point raw materials are obtained. Thus, "qualified property" would include tangible personal property defined in IRC Section 1245(a) for use by a qualified taxpayer in a line of business described in SIC Codes 1411 to 1499, that is primarily used for extracting of property, beginning at the point at which any raw materials are obtained. The value of any capitalized labor costs directly allocable to the construction or modification of such property also would be included in "qualified property."

This bill would specify that "qualified property" would not include equipment used in the extraction process, *except* nonmetallic mineral mining. This would allow equipment used in the extraction of nonmetallic mineral mining to qualify.

This bill would define "extracting" as the process of removing nonmetallic minerals from a mine.

Policy Considerations

This bill would raise the following policy considerations.

- Because this bill does not modify the binding contract rules in the current law MIC, this bill would provide a credit for qualified property purchased or leased pursuant to a binding contract entered into prior to enactment of this bill for activities undertaken prior to enactment of this bill, unless the costs were incurred pursuant to a binding contract entered into prior to January 1, 1994, in which case the current law binding contract rules would apply.

- This bill would not expand the MIC for Personal Income Tax law (PITL) taxpayers engaged in business relating to extracting nonmetallic minerals, creating inconsistent application of the MIC between PITL and B&CTL taxpayers. In addition, in the case of any MIC that is passed through from an S corporation to the shareholders, the shareholders would not be eligible to claim the credit.

Implementation Considerations

This bill does not make a corresponding change to the MIC under the PITL, which may cause taxpayer confusion. Taxpayers that are shareholders of an S corporation may be especially confused since the credit could not flow from the S corporation to the shareholder. This could lead to disputes between taxpayers and the department.

Technical Considerations

The addition of the phrase "obtained or" into the statutory definition of the manufacturing, processing, refining, fabricating, or recycling **process** definition under qualified property may inadvertently expand the activities qualifying for the MIC under current law. This is because the statute as proposed to be amended may permit taxpayers engaged in Division D (Manufacturing) activities that have related activities classified under the same SIC Code (because, for example, such related activities are small enough that, under the SIC Code classification rules, they are not assigned a separate code) to claim the MIC for qualified costs incurred with respect to activities related to "obtaining" raw materials to be used in the manufacturing, processing, refining, fabricating, or recycling process. Unless the author intends to broaden the MIC for existing qualified taxpayers, the department would suggest that the "extracting" activity addition be added instead as a new subparagraph (F) to paragraph (1) of subdivision (d).

FISCAL IMPACT

Departmental Costs

This bill would not significantly impact the department’s costs.

Tax Revenue Estimate

The revenue impact of this bill is estimated to be as shown in the following table:

Revenue Impact of AB 765, As Introduced February 24, 1999 Effective January 1, 1999: Assumed Enacted after June 30, 1999 $ Millions		
1999-2000	2000-2001	2001-2002
($3)	($4)	($4)

This analysis does not consider the possible changes in employment, personal income, or gross state product that could result from this measure.

Tax Revenue Discussion

The revenue impact of this credit would depend on the amount of qualified costs incurred and the tax liability of qualified taxpayers.

Qualified costs were estimated from U.S. Department of Commerce data. Applied credit amounts were estimated from tax returns filed by members of the industry.

This estimate assumes that the author does not intend to broaden the MIC for existing qualified taxpayers as discussed under technical considerations. If the author does intent to broaden the MIC, this estimate will be revised to reflect additional revenue losses attributable to expanding the MIC for existing qualified taxpayers.

BOARD POSITION

Pending.